

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
Friday, November 16, 2001
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the Conference Room of the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710-3776. Mr. Jim Bruner, Chairman, ASRS Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the 14th Floor Conference Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Jim Bruner, Chairman
Mr. Norman Miller, Vice Chairman (via teleconference)
Dr. Merlin DuVal
Ms. Bonnie Gonzalez (via teleconference)
Mr. Jim Jenkins
Mr. Alan Maguire (via teleconference)
Mr. Karl Polen (via teleconference)
Mr. Ray Rottas

Excused: Dr. Chuck Essigs

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the October 19, 2001 Regular Meeting of the ASRS Board

Motion: Dr. Merlin DuVal moved to approve the minutes of the October 19, 2001 regular meeting of the ASRS Board.

Mr. Jim Jenkins seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

3. Presentation of Plaques of Appreciation to Dr. Merlin DuVal and Mr. Jim Jenkins

Mr. Jim Bruner announced that Dr. DuVal's and Mr. Jenkins' terms as members of the Board expire in January 2002. He gave an overview of each of their service as officers of the Board and other affiliations, as well as the time and effort they contributed to the ASRS. He then presented each with a plaque of appreciation for their years of service and thanked them for their service.

Dr. DuVal said that it has been a pleasure to work with a state agency as well-run and successful as the ASRS. Mr. Jenkins concurred.

4. Board Approval of Consent Schedule

Motion: Dr. DuVal moved to approve the summary report of Retirements, Refunds and Death Benefits, System Transfers and Application and Agreements with the Following Employers,

- Self Development Charter School
 - Valley Academy for Career & Technology Education
 - North Star Charter School, Inc.,
- and the Contract Extension for Mercer Investment Consulting, Inc. and for Callan Associates, Inc.

Mr. Ray Rottas seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding the Actuarial Valuation of the Arizona State Retirement System for the Period Ending June 30, 2001

Mr. Lewis Ward, Consultant, Gabriel, Roeder, Smith & Company (formerly of Watson Wyatt), presented summary reports of the actuarial valuation of the ASRS and the Long-Term Disability (LTD) Program as of June 30, 2001. Information was presented illustrating the number of active and retired members, active payroll, average salary and benefit, market and actuarial values of assets, change in estimated yields based on actuarial value of assets and the contribution rates. The change in the contribution rate is summarized below:

BASIS	UAAL (\$ millions)	EE/ER RATE	RATE CHANGE	FUNDING PERIOD
2000 Valuation	(3,578)	2.00%	---	15
Expected Experience	(3,564)	2.00%	+0.00%	14
Actual Liability Experience	(3,424)	2.41%	+0.41%	14
Actual Asset Experience	(4,111)	1.66%	(0.75%)	14
Excess Earnings Reserve for Future Permanent Benefit Increases	(3,893)	1.87%	+0.21%	14
Legislative Changes	(2,587)	3.68%	+1.81%	14
Legislated Increase in Funding Period	(2,587)	3.86%	+0.18%	16
Change Due to Statutory Minimum Contribution Rate	(2,587)	3.86%	+0.00%	16

UAAL=Unfunded Actuarial Approved Liability

EE/ER=Employee/Employer Contribution rate

Mr. Norman Miller arrived at 8:41 a.m.

2001 LTD Valuation

	2001		2000	
	Projected in 2000	Actual 2001	Projected in 1999	Actual 2000
Beginning of Year Assets	\$88,938,892	\$88,938,892	\$69,306,799	\$69,306,799
Claims	(50,982,062)	(48,654,763)	(47,140,126)	(41,220,028)
Administrative Expenses	(1,954,333)	(2,033,261)	(2,057,214)	(1,954,333)
Premiums				
a. Current	41,038,530	39,916,721	38,212,482	37,750,897
b. Amortization	19,897,469	19,958,361	18,527,264	18,303,465
Investment Income	<u>7,337,324</u>	<u>14,964,779</u>	<u>5,749,279</u>	<u>6,752,092</u>
Net Change	15,336,928	24,151,837	13,291,685	19,632,093
End of Year Assets	104,275,820	113,090,729	82,598,484	88,938,892
Rate of Return		14.81%		8.91%
UAAL		120,239,272		121,356,794
Projected Cost		1.05%		1.00%

Total Contribution Rate for Retirement and LTD Programs

Fiscal Years 1999/2000 and 2000/2001	401(a) Account	401 (h) Account	Total Retirement	LTD Program	Total of Both Programs
(1)	(2)	(3)	(4)	(5)	(6)
Employee Rates	2.17%	0.00%	2.17%	0.49%	2.66%
Employer Rates	<u>1.25%</u>	<u>0.92%</u>	<u>2.17%</u>	<u>0.49%</u>	<u>2.66%</u>
Total Rates	3.42%	0.92%	4.34%	0.98%	5.32%

Fiscal Years 2001/2002 and 2002/2003	401(a) Account	401 (h) Account	Total Retirement	LTD Program	Total of Both Programs
(1)	(2)	(3)	(4)	(5)	(6)
Employee Rates	2.00%	0.00%	2.00%	0.49%	2.49%
Employer Rates	<u>1.94%</u>	<u>0.06%</u>	<u>2.00%</u>	<u>0.49%</u>	<u>2.49%</u>
Total Rates	3.94%	0.06%	4.00%	0.98%	4.98%

Motion: Mr. Rottas moved to accept the Actuarial Valuation of the Arizona State Retirement System and the LTD Program as of June 30, 2001.

Mr. Jenkins seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance for the period ending September 30, 2001

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc. (Mercer), presented an economic and market review and reported on the Total Fund Performance for the period ending September 30, 2001.

Mr. Rottas pointed out that the ASRS is currently 112% funded, which should assure members of the ASRS. Mr. Dennison reiterated that the ASRS is well-funded and conservatively managed so the assets and benefits are secure.

Total Fund Performance for Period Ending September 30, 2001

	Qtr	1 Year	3 Years	5 Years	10 Years
Total ASRS Fund	-9.7%	15.6%	5.0%	9.1%	10.8%
Benchmark*	-8.8	-16.1	2.7	7.6	9.4
TUCS Public Fund Median	-7.8	-13.6	4.6	7.8	9.8

*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate
1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE
1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE
7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE
1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE

Mr. Miller asked if the government's decision to withdraw new issues on 30-year treasuries is temporary. Mr. Dennison responded that most analysts believe it may be permanent because 30-year debt is expensive for the government and it wants to decrease the cost of borrowing. Mr. Miller then asked if the money managers had the ability to invest in Treasury Inflation Protected Securities (TIPS) products. Mr. Paul Matson confirmed that they do, and Mr. Dennison said that the Fed has signaled that it will discontinue TIPS because they are also relatively high-cost debt.

Performance vs. Benchmarks for the 3 Years Ending September 30, 2001

	Return	Assumed ROR	Std. Dev.	Assumed Std. Dev.
Total ASRS Fund	5.0%	8.4%	14.4%	11.8%
Benchmark	2.7%		13.1%	
Domestic Fixed LB Aggregate	6.3 6.4	5.6	3.9 3.7	5.3
Domestic Equity S&P 500	3.7 2.0	9.4	21.8 21.2	16.3
International Equity EAFE	5.5 -0.9	10.0	22.5 21.0	21.5

Performance vs. Benchmarks for the 5 Years Ending September 30, 2001

	Return	Assumed ROR	Std. Dev.	Assumed Std. Dev.
Total ASRS Fund	9.1%	8.4%	13.3%	11.8%
Benchmark	7.6%		12.2%	
Domestic Fixed	8.2	5.6	3.9	5.3
LB Aggregate	8.1		3.5	
Domestic Equity	10.5	9.4	19.9	16.3
S&P 500	10.2		19.6	
International Equity	3.8	10.0	21.2	21.5
EAFE	0.1		19.8	

7. Presentation, Discussion and Appropriate Action Regarding the Performance of the MidCap Managers for the Period Ending September 30, 2001

Mr. Dennison reported on the performance of the ASRS E3, Mellon Equity, and State Street Global Advisors for the period ending September 30, 2001.

Mr. Michael Viteri, Equity Portfolio Manager, reported on the ASRS E3's performance for the period ending September 30, 2001.

	Quarter 9/30/01	Inception (12/00)
Sector Weightings	0.01	0.04
Security Weights	0.01	0.04
Futures & ETFs	0.03	0.20
Trading of Index Changes	0.00	0.38
Investment Management Fees	-0.00	-0.00
Total Value Added	0.05	0.66

Dr. DuVal asked if the Arizona Department of Administration self-insures any portion of what they cover the portfolio for, such as general liability, or if it is insured through commercial carriers. Mr. Matson said he would provide the research that has been done on the policy to the Board members.

Mr. John R. O'Toole, CFA, Senior Vice President and Mr. John J. Dagenhard, Senior Vice President, reported on Mellon Equity's performance for the period ending September 30, 2001.

	Quarter 3 2001	One Year Ending 9/30/01	Annualized Since Inception
Total Rate of Return			
Sector Selection	-.08%	-.49%	-.28%
Stock Selection	-.57	-.08	-2.34
Other	+1.30	-2.23	-1.18
Fees	-.05	-.20	-.20
Total Value Added	+.60	-3.00	-4.00

Ms. Susan R. Bonfeld, Principal, Client Services, and Mr. James B. May, Principal, Portfolio Manager reported on State Street Global Advisor's performance for the period ending September 30, 2001.

Total Account	Quarter 3 2001	Inception (1/31/00)
ASRS	-16.53%	1.53%
S&P MidCap 400	-16.56	1.11
Value Added	0.03	0.42%
Attribution Analysis		
Futures	0.00	0.02
Cumulative Misweights	0.00	0.02
Trading of Index Changes	0.04	0.08
Fees	-0.01	-0.02
Trading of Initial Contribution	0.00	0.32
Value Added	0.03	0.42

Mr. Ray Rottas asked if the acquisition of the passive equity business of Gartmore Investment Management was a cash or stock exchange. Ms. Bonfeld did not know the exact structure of the transaction but would provide the information to the Board.

8. Presentation, Discussion and Appropriate Action Regarding the Investment Management Charter

Mr. Alan Maguire reported that the Investment Review Board Committee (IRBC) met on November 6, 2001, to discuss the Investment Management Charter, Policies and Procedures, and the 2002 Investment Manager Review Schedule.

With regard to the charter, most of the changes are administrative or technical, reforming existing language to reflect new circumstances and titles of staff.

Motion: Mr. Maguire moved to approve the changes in the Investment Management Charter.

Mr. Miller seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

9. Presentation, Discussion and Appropriate Action Regarding New and Revised Investment Management Policies and Procedures

Mr. Maguire noted several Policies and Procedures changes. The Board authorizes an increase to maximum limit of financial futures contracts for internal management of assets and portfolios, from three to five percent of the portfolio. These contracts will not be used for leveraging purposes. The futures policy was also amended to allow up to 25 percent of a portfolio to be in futures in order to facilitate transition of portfolios between managers.

A proposed new policy would give Internal Investment Management authority to trade futures contracts and Exchange Traded Funds (ETFs) to equitize cash held by the retirement system and LTD. The purpose is to obtain the capital market expense to further the investment goals of the ASRS and again,

will not be used to obtain a leveraged position. An additional policy would authorize members of Investment Management to trade futures contracts and ETFs, as delegated by the Chief Investment Officer.

Mr. Miller requested that the Definition in the policies include a statement defining financial futures so there is clear understanding of the meaning. He also requested that the current statement in the Authority to Trade Financial Futures be moved to the Procedure section. Mr. Matson agreed and said a standard definition of financial futures will be added.

Another policy deals with authorization to utilize Master and Long-term Disability (LTD) cash on a temporary basis to settle pending trades and margin requirements for the overall investment fund and portfolios, but the cash must be transferred back to the Master or LTD cash accounts within 90 days. A new policy would also allow the delegation of this authority.

Motion: Mr. Maguire moved to approve the new and revised Investment Management Policies and Procedures as amended.

Mr. Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

10. Presentation, Discussion and Appropriate Action Regarding the 2002 Investment Manager Review Schedule

Mr. Maguire reported that at the November 6, 2001, IRBC meeting, the schedule for manager reviews was discussed and revised to allow appropriate time for extensive reviews. He suggested, however, doing the Asset Allocation Study in 2002 rather than 2003.

Mr. Polen requested that the Tactical Asset Allocation (TAA) review be accelerated, in order to decide if it is a viable concept and whether the ASRS should keep it as part of the strategic allocation. If it were, he would also like to accelerate the manager review/search. Mr. Matson responded that the consultant is preparing a presentation on the appropriateness of that strategy and staff are preparing information for a possible Request for Proposal (RFP). Mr. Polen also requested the Asset Allocation Study include a broader look at some of the assets that the ASRS is not currently invested in.

Motion: Mr. Maguire moved to approve the 2002 Investment Manager Review Schedule as distributed and amended to move the Asset Allocation Study from 2003 to 2002.

Mr. Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

11. Presentation, Discussion and Appropriate Action Regarding the Contract Award for Actuarial Services

Ms. Bonnie Gonzalez reported that members of the Budget and Long-Range Planning (BLRP) Board Committee reviewed the proposals for an actuary and interviewed the most viable candidates. Based on the work done by staff and the committee, she recommended contracting with Buck Consultants for the services.

Motion: Ms. Gonzalez moved to award the contract for actuarial services to Buck Consultants.

Mr. Maguire seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

12. Presentation, Discussion and Appropriate Action Regarding the Schedule for Meetings of the ASRS Board for the Calendar Year 2002

Mr. Bruner reviewed the proposed schedule of Board meetings for the year 2002, noting that two meetings will be held in Tucson and one in Flagstaff.

Motion: Mr. Jenkins moved to approve the schedule for meetings of the ASRS Board for the calendar year 2002.

Mr. Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

Mr. Maguire expressed his belief that there is enough work for the Board to meet at least 12 times a year. He also recommended moving the location of the meetings around the state so the Board can take the opportunity to communicate with members and employers. He also informed the Board members a special meeting might be required in December to address the Defined Contribution Plan authorized by the legislature during the last session.

13. Presentation, Discussion and Appropriate Action Regarding the SmallCap RFP Award

Mr. Maguire reported that the RFP Evaluation Committee reviewed five mandates for SmallCap management. The committee received 130 responses for those mandates, which were reviewed in detail. The committee held two meetings in September to review the responses and met in October to interview managers. He reviewed the shortlist of managers and the recommendation of the committee.

Motion: Mr. Maguire moved to award the contract for Domestic Equity SmallCap investment money management to the following:

SMALL CAP PASSIVE	Mellon Capital Management Corp.
SMALL CAP ENHANCED	No funds be allocated to this mandate.
SMALL CAP CORE	Axe Houghton Associates, Inc. Batterymarch, on an unfunded basis, as an alternative manager.
SMALL CAP GROWTH	Columbia Management Co. Strong Capital Management, Inc., on an unfunded basis, as an alternative manager.
SMALL CAP VALUE	Dimensional Fund Advisors, Inc. Termination of Brandywine Asset Management Strong Capital Management, Inc., on an unfunded basis, as an alternative manager.

The contract award is one year, with four renewal periods of one year each.

Mr. Rottas seconded the motion.

Mr. Miller asked if the unfunded alternate managers' performance would be tracked during the term of the contract for comparison purposes with those that are funded. Mr. Maguire responded that the committee had discussed tracking the performances of the alternate managers using the services of Mercer Consulting. Mr. Dennison agreed it would be appropriate and easily possible for Mercer to track the performances without additional costs. Mr. Polen noted that the intention of having an alternate manager is to have a backup plan, so it is necessary to track the performance so the ASRS is in the position to use them.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

14. Presentation, Discussion and Appropriate Action Regarding a Deputy Director of External Operations

Mr. LeRoy Gilbertson, Director, reported that the ASRS reviewed over 100 résumés for the position of Deputy Director of External Operations. Mr. Bruner and Mr. Miller interviewed the candidates staff recommended. The recommended candidate is highly qualified.

Mr. Bruner said he interviewed several of the finalists and concurred with the recommendation of Mr. Gilbertson, as well as the comments of two respected individuals in the legislature who know the person. The candidate is Mr. Richard L. Stephenson, who has been involved in legislative activities for over 20 years and will be a fine addition to the staff.

Motion: Dr. DuVal moved to approve the hiring of Mr. Richard Stephenson for the position of Deputy Director of External Operations

Mr. Rottas seconded the motion.

Mr. Maguire commented that he did not have a chance to meet Mr. Stephenson and is not familiar with his background. He expressed disappointment that all Board members did not meet Mr. Stephenson before this item was put on the agenda and therefore he will abstain from the vote.

By a vote of 7 in favor, 0 opposed, 1 abstention, 1 excused, the motion was approved.

15. Director's Report

Mr. Gilbertson reported that the ASRS staff continues to meet with state legislators to provide information, particularly with regards to retirement windows in bills coming out of the House. Mr. Maguire requested that any information given to legislators be provided to members of the Board.

Mr. Miller asked if, in the context of the Special Session regarding the budget, there are any concerns about the state asking for a reduction in the contribution rate. Mr. Gilbertson answered that the idea was discussed but has since been dropped.

16. Board Requests for Agenda Items

Mr. Maguire requested the Board also receive any legislative proposals for the next session. Mr. Miller, Chairman of the External Affairs and Legislative Board Committee, said he has asked the staff for suggestions for any legislative changes. Staff has recommended some housekeeping changes and should provide a topical list to Board members. Mr. Miller also formally asked Board members to provide legislative proposals to him and the staff.

Mr. Ray Rottas asked if it was possible to get any proposed action from legislative council ahead of time so that necessary contact can be made. Mr. Miller answered in the affirmative.

17. Call to the Public

Mr. William O'Donald, of Tucson, expressed concern about the senior supplement health insurance offered by the ASRS and compared the price of the premium and benefits offered with those of another supplemental plan. He also asked if it was possible to have a third-party pay his supplement. Mr. Gilbertson said that the employer has to agree to do it.

Mr. Martin Drozdoff, of the Tucson Education Association, thanked the Board for coming to Tucson and expressed his appreciation for the job the ASRS is doing with the investments. He also asked a question about the new 401(a) plan. Mr. Gilbertson reported that the ASRS is moving ahead with it and plan to get it in place by the end of the year.

There were no requests to speak in Phoenix.

18. The next regular ASRS Board meeting is scheduled for Friday, January 18, 2002, at 8:30 a.m. in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910.

19. Adjournment of the ASRS Board.

Mr. Bruner adjourned the November 16, 2001, regular meeting of the ASRS Board at 11:19 a.m.

Respectfully submitted,

Maurah Harrison, Secretary

Date

LeRoy Gilbertson, Director

Date